SUPREME COURT OF THE UNITED STATES.

No. 130.—October Term, 1927.

The Equitable Trust Company of New York, Trustee in Bankruptcy of Knauth, Nachod & Kuhne, Petitioner,

vs.

The First National Bank of Trinidad, Colorado.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 3, 1928.]

Mr. Justice Holmes delivered the opinion of the Court.

Knauth, Nachod and Kuhne being in bankruptcy, the respondent, The First National Bank of Trinidad, Colorado, claimed priority in respect of certain funds collected by the trustee in bankruptcy, the petitioner, from the Banca Commerciale Italiana; the ground of the claim being that these funds were charged with a trust in the hands of the Italian bank. The respondent prevailed in the Circuit Court of Appeals. 13 F. (2d) 732. A writ of certiorari was granted by this Court. 273 U. S. 684.

The facts are as follows. The bankrupts had credit with many foreign banks and to enable small banks in this country to issue drafts upon such banks in their own name offered these terms: "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit from our balance, or otherwise, provided the draft is drawn on a bank named in our latest list of correspondents." It was added that the drawing banks act as principals and draw in their own name, the bankrupts being employed merely "as agents of the drawers for the purpose of advising the issue of their drafts and providing the drawee banks with sufficient funds to cover their payment."

The bankrupts sent out lists of their foreign correspondents and also daily rate cards fixing the rate for the various foreign currencies, including their own compensation, good only for the day of the date. In accordance with this plan the Trinidad bank drew a draft on a branch of the Banca Commerciale Italiana for 24360 lire, sent notice to the bankrupts that they had sold it "and shall thank you to protect same upon presentation," and remitted therewith a check for $1,191.20, which the bankrupts received on May 22, 1923, and deposited to their general account. On the same day the bankrupts sent to the Italian bank and to its branch a list and description of the drafts issued by inland banks and by the bankrupts and requested it to "honor the above listed drafts charging same to our account." The list was received on or before June 4, 1923; the account of the bankrupts was debited with the total amount and to that extent ceased to draw interest, the bank getting its compensation in this way. At the same time an account termed "Drafts Payable" was credited with the same amount, this account being credited in the same way with drafts from other dealers with the bank and the bankrupts themselves. In accordance with the practice in international banking, the bankrupts when they saw fit to do so cancelled their advices and were recredited in their general account; and although in fact they did not cancel the advice of inland drafts except when requested by the inland banks, the Italian bank did not know or inquire into reasons and so far as appears the Trinidad bank or at all events the holder of the draft knew nothing of the mode of bookkeeping described.

The draft was presented after the petition in bankruptcy had been filed and was dishonored; the petitioner as drawer had to take it up and now claims on the two grounds that the sum paid by it was paid upon trust to be applied to the draft, and that as holder of the draft it is, by subrogation, an equitable assignee of the bankrupts' deposit with the drawee. The first of these need not detain us. *Beecher* v. *Cosmopolitan Trust Co.*, 239 Mass. 48, *Legaiti* v. *The Mechanics & Metals National Bank*, 230 N. Y. 415. The identity of the fund was not maintained and no one expected it to be. See *National City Bank* v. *Hotchkiss*, 231 U. S. 50, 56, 57. The bankrupts undertook to 'forward' advice but only to 'provide' the drawee with funds. The second contention was that which prevailed below. Of course there is room for difference

if the parties did not express very clearly what they wanted or meant but we are led to a different conclusion whether the reliance be upon the rights of the holder or upon the original contract between the respondent and the bankrupts. In the first place the ignorance of the whole affair on the part of the holder and the general understanding that the party dealing immediately with the bank having the 'Bills Payable' account is master of it, as between himself and the bank, are quite inconsistent with the notion that an entry on that account is the appropriation of a fund to the holder's use. The respondent tries to give a different turn to the evidence but the master's finding and our own conclusion from the testimony leave no doubt in our minds. It is true that after such an entry the interest allowed to the depositor stops but that is only a convenient way of giving compensation to the bank. It is not uncommon in commercial transactions to see some of the elements of an earlier or a half imitated transaction appear, although the essentials of the transaction are not there. Whether a fund was appropriated or not depended wholly on the dealings between the bankrupts and the Italian bank; and both of them dealt with the account as subject to the bankrupt's control. The cessation of interest was for the benefit of the bank because the account was only with its general funds, and did not have any assets especially set aside and appropriated to it—in short was a bookkeeping device for the convenience of the bank.

Again, the terms offered by the bankrupts to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee banks with sufficient funds for the payment of the drafts by transfer of credit from our balance 'or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee banks, not to give them an earmarked corpus to be handed over. They are requested by their correspondents to protect the drafts, which again means merely to see that they are paid. *Wabash, St. Louis & Pacific Ry. Co.* v. *Ham*, 114 U. S. 587, 596. People dealing with large banks do not ordinarily seek the ambiguous security of an identified fund, they are satisfied if the bank gives them credit. We see no indications that the Trinidad bank was not perfectly

content to know that it would have credit with the Banca Commerciale, and that in the usual course of things its drafts would be paid. Evidently with this conception of their duties the bankrupts asked the Italian bank "to protect to the debit of our account the drafts" in question and others, and the branch bank to "honor the above listed drafts." That such a letter of advice is not an assignment is clearly explained in *Eastman Kodak Co.* v. *National Park Bank*, 231 Fed. Rep. 320, 323; (affirmed, 247 Fed. Rep. 1002.)

We have called the instrument under which the respondent claims as assignee, a draft. But on its face it is called 'check'. The form was a general form furnished by the bankrupts and the purpose is said to have been that in continental Europe or some parts of it checks are not subject to the same stamp tax as drafts. It is said in a reputable work that the fact that the instrument purports to be drawn upon a deposit is what constitutes it a check. Daniels, Negotiable Instruments, 6th ed., § 1569. The existence of this opinion sufficiently explains the words of the document before us 'Pay from balance against this check'. They no more purport to assign a fraction of a fund than does an ordinary check. They would not naturally take that shape as the respondent, the drawer of the check, had no fund in the hands of the drawee.

The decision of this case depends more upon the general import of the transaction and upon what the parties were likely to want than upon the phrases that can be picked out from the several steps. We repeat that in our opinion what the parties meant to establish and what the respondent got was the assurance of a credit abroad to the extent of its check as in the case of a letter of credit, not an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know.

Order reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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Mr. Justice Stone, dissenting.

The agreement of the bankrupts, on the faith of which petitioner sold its draft, did more than stipulate that the draft should be paid on presentation. It provided specifically the method of payment; that the bankrupts should "promptly", on notice of the draft, "provide the drawee with funds sufficient for the payment of the draft abroad, by a transfer of credit or otherwise." It plainly contemplated the course of business, actually followed, in which a credit, to be established with the drawee, was to be set apart and specifically appropriated to the payment of the draft. The draft was by its terms made payable from "balance against this Check".

We need not discuss what the petitioner's rights would have been if no such credit had been established, for here the bankrupts had performed their contract fully and to the letter. They set apart the stipulated credit. Withdrawal of it by them would have been a violation of their contract with petitioner, for the contract contained no intimation of a right to revoke it, and if the receiver had not done what they had no right to do the draft would have been paid. Nor does it appear to me that the real question is whether the Italian bank was charged with a trust with respect to funds lodged with it by the bankrupts. It may be assumed that it was not a trustee, but only a debtor to the bankrupts for the funds thus received, with power to discharge the debt *pro tanto* by payment of the draft when presented.

Stated with precision the question seems rather to be whether, since the bankrupts had performed their agreement by specifically designating and setting apart enough of their credit with the Italian bank to meet the draft, the credit thus set apart is to be treated in equity as security for the payment of the draft. If subject to that equitable obligation, neither the bankrupts nor the receiver could convert the credit, so set apart, into cash and turn the proceeds over to general creditors freed of that obligation.

Since *Holroyd* v. *Marshall*, 10 H. L. Cas. 191, it has been generally accepted doctrine, the recording acts permitting, that an agreement to hold property which the promisor may afterward acquire as security for the payment of a debt, operates in equity once the property is acquired, to give the stipulated security to the promisee in preference to general creditors. Such is the rule in this Court. *Sexton* v. *Kessler*, 225 U. S. 90. I had supposed it to be equally well settled that the agreement need not mention the word "security" to accomplish that result, if its plain purpose is to provide for the satisfaction of a debt or obligation out of identifiable property. Compare *Walker* v. *Brown*, 165 U. S. 654; *Ingersoll* v. *Coram*, 211 U. S. 335; *Hurley* v. *Atchison, Topeka & Santa Fe Ry.*, 213 U. S. 126; *Ketchum* v. *St. Louis*, 101 U. S. 306; *Parlin & Orendorff Implement Co.* v. *Moulden*, 228 Fed. 111; *Curtis* v. *Walpole Tire & Rubber Co.*, 218 Fed. 145. There has been no dissent from the view that an agreement to apply a designated credit or account to the payment of a check or draft drawn upon it creates security in the credit enforcible in equity as against general creditors. *Fourth Street Bank* v. *Yardley*, 165 U. S. 634; *Farley* v. *Turner*, 35 L. J. Ch. 710; *Coates* v. *First National Bank*, 91 N. Y. 20; *Muller* v. *Kling*, 209 N. Y. 239; *In re Hollins*, 215 Fed. 41. Equity, in making such agreements effective, does no more than it habitually does in compelling the performance of an agreement to give a mortgage to secure advances made on the faith of the agreement.

Both parties to this transaction knew that American drafts drawn on European banks would be worthless unless definite arrangement for their payment by the drawee was made in advance of their presentation, and that where, as here, a particular credit was set apart for that purpose the utility of such drafts would

be seriously impaired if the credit, once established, could be cancelled at will. No intelligent banker would sell such drafts if the establishment of such a credit were not contemplated. A bank here, drawing and selling such drafts against a credit to be established abroad by others, pledges its own credit to the payee and is secured against loss and the dishonor of its drafts only in so far as it may insure the creation of the appropriate credit and retain the benefit of it once it is created. The stipulation that the bankrupts should promptly set apart a credit for that purpose upon receipt of advice of the draft and advise the drawee of it was a material inducement to petitioner to pledge its own credit by the sale of its draft. Once performed it is valuable security to both payee and drawer, if it is permitted to have the legal sanctions which ordinarily attach to agreements of this character.

The evidence in this case appears to me, as it did to the court below, to fall far short of establishing a practice or custom, or any rule of Italian law, permitting the depositor, while the drafts are outstanding, to cancel or control for his own purposes the credit set apart for their payment. Our own rule is that a bank of deposit may not, with impunity, ignore the known equitable rights of others to the credit established by its depositor, *National Bank* v. *Insurance Co.*, 104 U. S. 54, and it would seem that that rule should be applied here in determining the rights of the parties in the absence of proof of any other. But in any case, such control, if retained by the bankrupts as between themselves and the Italian bank, could not be rightfully exercised in violation of their contract with petitioner.

The case would therefore seem to be a proper one for the application of the rule announced by this Court in *Fourth Street Bank* v. *Yardley*, *supra*, that a court of equity will lend its aid to carry into effect an agreement that an obligation shall be satisfied out of a specified credit. Applied here that rule would make effective the intention of the parties and give stability to a large and important class of banking transactions. The judgment should be affirmed.

Mr. Justice McReynolds joins in this dissent.